

Message Text

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PAGE 01 KUWAIT 03338 01 OF 02 130755Z

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ACTION NEA-10

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FM AMEMBASSY KUWAIT

TO SECSTATE WASHDC 5758

INFO USDOC WASHDC

DEPT OF TREAS WASHDC

AMEMBASSY JIDDA

AMEMBASSY TEHRAN

LIMITED OFFICE USE SECTION 1 OF 2 KUWAIT 3338

DEPT PASS MENDENHALL, DEPT OF TRANSP/FHWA AND OPIC

COMMERCE FOR CAGNE/HEARN

TREASURY FOR OSAA

E.O. 11652: N/A

TAGS: BEXP, EFIN, ECRE, EAID, FHWA, KU

SUBJ: PERFORMANCE BOND ON CONSTRUCTION CONTRACTS: RESULTS OF
TREASURY REP. MCFADDEN VISIT

REF: (A) STATE 162714, (B) KUWAIT 2970 AND PREVIOUS

1. SUMMARY: DURING VISIT OF TREASURY REP HUGH MCFADDEN, FOLLOWING
UP ON FEBRUARY SURETY BOND TEAM VISIT, IT WAS LEARNED THAT FOK
MINISTRY OF PUBLIC WORKD (MPW), WITH GENERAL APPROVAL OF ITS
UNDERSECTARY, IS INTERESTED IN IMPLEMENTING SURETY BOND
PROPOSAL DISCUSSED THEN FOR THE MOTORWAYS PROJECT. LEGAL AND
PHILOSOPHICAL OPPOSITION OF EQUALLY SENIOR MPW OFFICIALS TO ANY
CHANGE IN CURRENT PERFORMANCE GUARANTEE REQUIREMENTS, COUPLED WITH
SKEPTICISM OF PRIVATE BANKING REPS AS TO CAPACITY AND WILLINGNESS
OF LOCAL FINANCIAL INSTITUTIONS TO ISSUE SURTY BONDS, INDICATES
THAT MUCH CONVINCING WORK REMAINS TO BE DONE. EMBASSY IS PROPOSING
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PAGE 02 KUWAIT 03338 01 OF 02 130755Z

THAT ISSUE BE TACKLED ON THREE LEVELS: A) AT PROJECT LEVEL,

BY CONTINUED CONTACTS WITH MPS PROJECT ENGINEERS; B) AT EXECUTIVE LEVEL BY DIALOGUE BETWEEN AMBASSADOR AND RELEVANT GOK MINISTERS; AND C) AT OFFICIAL LEVEL BY VISIT OF COMBINED USG/US SURETY BOND-INDUSTRY TEAM. END SUMMARY.

2. TREASURY REP HUGH MCFADDAN, ACCOMPANIED BY EMBASSY ECON/COMML OFFICER DISCUSSED FURTHER ASPECTS OF PERFORMANCE GUARANTEE/ SURETY BOND PROBLEM DURING SHORT, TWO-DAY STAY IN KUWAIT (JULY 5-6) WITH FHWA TECHNICAL ADVISOR LOUIS MACDONALD; CHAIRMAN OF KUWAIT CENTRAL TENDERS COMMITTEE, WILLIAM SHUHAIBAR; AND, ADVISOR TO MINISTER MAHMOUD RIAD (ALL WORKING WITHIN GOK MINISTRY OF PUBLIC WORKS); ARTHUR ROGERS, COMML. MGR., BANK OF KUWAIT AND MIDDLE EAST; AND, KEITH THOMPSON, SR. REP., BECHTEL CORP. MAIN POINTS OF MCFADDEN PRESENTATION WERE: A) VIRTUES OF CONDITIONAL BOND SYSTEMS VERSUS ON-DEMAND PERFORMANCE GUARANTEE INSTRUMENT; AND, B) NATURE AND QUALITY OF LOCAL SURETY INDUSTRY REPRESENTATION (AGENCY, INSURANCE COMPANY, BANK). (MCFADDEN NOTED THAT U.S. SURETY INDUSTRY, PREVIOUSLY UNWILLING TO WORK WITH LOCAL FIRMS, HAD NOT MODIFIED ITS ATTITUDE SOMEWHAT (REF A, PARA 2).)

3. MACDONALD AND MCFADDEN DISCUSSED SPECIFIC APPLICATIONS OF SURETYBOND ALTERNATIVE TO KUWAIT MOTORWAYS PROJECT. AS NOTED REF B, MACDONALD HAS BEEN GIVEN AN INFORMAL GO-AHEAD BY CHIEF ENGINEER AND UNDERSECRETARY OF MPW TO GATHER INFORMATION IN ORDER TO DRAW UP CONTRACT SPECIFICATION INVOLVING USE OF SURETY BONDS. MACDONALD WAS CONFIDENT THAT ONCE APPROPRIATE INFORMATION HAD BEEN PROVIDED, MPW WOULD ACCEPT HIS RECOMMENDATION THAT SURETYBONDS BE USED. HE OBSERVED, HOWEVER, THAT BOTH HE AND HIS SUPERIORS WERE VERY MUCH IN DARK REGARDING DETAILS OF IMPLEMENTING SUCH PROPOSALS, I.E., FORM OF SURETY BOND CONTRACT AND NATURE OF LOCAL REPRESENTATION. MACDONALD FELT, IN RESPONSE TO MCFADDEN INQUIRY, THAT MPW WANTED LOCAL CONTACT WITH WHOM IT COULD DEAL DIRECTLY, ACTUAL FORM OR REPRESENTATION, HOWEVER, WOULD BE FLEXIBLE, PERHAPS LIMITED TO LOCAL AGENT FOR U.S. OR FOREIGN SURETY COMPANY.

4. DIFFERENT, MORE PESSIMISTIC VIEW WAS OFFERED BY OTHER SENIOR MPW OFFICIALS. SHUHAIBAR QUOTED FROM GOK TENDER LAW TO EFFECT THAT A) PERFORMANCE GUARANTEES WERE PAYABLE AT GOK REQUEST AND DESPITE ANY CONTRACTOR CONTESTATION; AND, B) THAT LIMITED OFFICIAL USE

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PAGE 03 KUWAIT 03338 01 OF 02 130755Z

GUARANTEES MUST BE ISSUED BY LOCAL BANK, OR LOCAL INSURANCE COMPANY APPROVED BY LOCAL BANK (THOUGH POSSIBILITY OF FOREIGN BANKS OR SURETY COMPANIES ISSUING COUNTER-GUARANTEES WAS NOT EXCLUDED). SINCE TENDER LAW PROCEDURES ARE DETERMINED BY GOK NATIONAL ASSEMBLY LEGISLATION, GOK WOULD, ACCORDING TO SHUHAIBAR, BE RELUCTANT TO TAMPER WITH THEM.

5. RIAD ADDED PHILOSOPHICAL OBJECTIONS TO INTRODUCTION OF SURETY

BONDS. DESPITE LARGER GUARANTEE PERCENTAGE (UP TO 100 PERCENT), AND EMPHASIS ON OBTAINING COMPLETION OF PROJECT WITH MINIMUM DISAGREEMENT THAT, MCFADDED NOTED, SURETY BONDS OFFERED, RIAD FELT THAT 10 PERCENT ON-DEMAND WAS SURE WEAPON FOR GOK TO OBTAIN SATISFACTORY PERFORMANCE. HE NOTED THAT ARBITRATION PROCEDURES, WHETHER INTERNATIONAL OR LOCAL IN FORM, TOOK TIME THAT THE MPW, ENGAGED IN SUPPLY OF PUBLIC SERVICES THAT COULD NOT WAIT, COULD NOT JUSTIFY. RIAD WAS ALSO SKEPTICAL OF CAPACITY OF LOCAL FINANCIAL INSTITUTIONS TO ISSUE AND PAY UP ON SURETY BONDS, CITING AS EXAMPLE REFUSAL OF LOCAL INSURANCE COMPANY TO PAY OFF ON CLEAR-CUT FIRE INSURANCE POLICY.

6. ON POSITIVE SIDE, HOWEVER, BOTH SHUHAIBAR AND RIAD NOTED THAT GOK WAS NOT AS STRICT IN ITS REQUIREMENTS AS SOME OTHER STATES. IN PARTICULAR, TENDER LAW ITSELF DOES NOT APPLY TO SEVERAL INSTITUTIONS AND AREAS OF THE KUWAITI ECONOMY--OIL AND PETRO-CHEMICAL, HOUSING, AND DEFENSE CONSTRUCTION BEING THE MOST IMPORTANT. RIAD ALSO OBSERVED THAT 10 PERCENT FIGURE FOR PERFORMANCE GUARANTEE WAS NOT ALWAYS RIGIDLY APPLIED. ON VERY LARGE PROJECTS WHOSE VALUE WAS ABOVE A SPECIFIED CUT-OFF POINT, PERCENTAGE WAS ADJUSTED SO THAT, IN SOME CASES, ACTUAL FIGURE WAS CLOSER TO FIVE PERCENT.

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PAGE 01 KUWAIT 03338 02 OF 02 130640Z

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ACTION NEA-10

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TO SECSTATE WASHDC 0000
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7. FINALLY, MCFADDEN AND EMBOFF DISCUSSED WITH ROGERS CAPACITY OF LOCAL KUWAITI FINANCIAL INSTITUTIONS TO DEAL WITH SURETY BONDS. ROGERS, RESPONDING TO SPECIFIC QUESTION BY MCFADDEN, STATED THAT, IN ALL PROBABILITY, KUWAITI BANKS WOULD BE UNWILLING TO ISSUE AN UNCONDITIONAL GUARANTEE EITHER ITSELF OR FOR LOCAL INSURANCE FIRM, BACKED UP BY FOREIGN SURETY BOND, CITING PROBLEMS OF TIMING AND "COMING UP SHORT". HE INTERPRETED GOK REGULATIONS ON ABILITY OF BANK TO "APPROVE" LOCAL INSURANCE FIRM'S GUARANTEE AS MEANING AN ASSUMPTION OF FINANCIAL RISK, AND, ON THIS BASIS, DOUBTED ABILITY OF BANKS TO SUPPORT IN-EXPERIENCED LOCAL INSURANCE FIRMS IN ISSUING SURETY BOND GUARANTEE.

8. COMMENT: DIFFERENCES BETWEEN MPW PROJECT MANAGERS, RESPONDING TO CONTRACTOR COMPRJINTS AND INTERESTD IN OBTAINING PARTICIPATION OF PARTICULAR TYPE OF FIRM FOR SPECIF PROJECT, AND SENIOR CONTRACT NEGOTIATING OFFICIALS, CHARGED WITH IMPLEMENTING BOTH NATIONAL ASSEMBLY LEGISLATION AND MPW TENDERING PROCEDURES, WAS EVIDENT DURING MCFADDEN VISIT. DIVISION APPLIES BOTH TO NATURE OF SURETY LIMITED OFFICIAL USE

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PAGE 02 KUWAIT 03338 02 OF 02 130640Z

BOND, AND MECHANISM BY WHICH SUCH BONDS CAN BE ISSUED IN KUWAIT. THOUGH UNWILLINGNESS TO ALTER BASIC LEGISLATION PLAYS SOME ROLE, OPPOSITION TO SURETY BONDS THEMSELVES, ON GOUNDS OF UNCERTAINTY OF CONDITIONAL INSTRUMENT AND OF INCAPACITY OF LOCAL SURETY INDUSTRY, IS OBVIOUSLY DEEPLY ROOTED AMONG CERTAIN MPW OFFICIALS. EMBASSY FEELS THAT TO OVERCOME IT, USG MUST CONVINCE BOTH PROJECT MANAGERS AND MPW AND OTHER MINISTERS OF DESIRABILITY OF CHANGES IN GOK GUARANTEE PROCEDURES. EMBASSY HAS IN PAST FELT THAT GOK WOULD CONSIDER CHANGES ONLY OMNCASE-BY-CASE BASIS. MPW PROJECT MANAGERS FAVOURING SURETIES ON SPECIFIC PROJECTS WOULD UNDOUBTEDLY BE PERSUASIVE WITH MORE SENIOR GOK OFFICIALS. NEVERTHELESS, EMBASSY BELIEVES THAT APPROACH SHOULD BE MADE IN FORM OF LETTER OR DIRECT MEETINGS WITH RELEVANT MINISTERS TO FAMILIARIZE THEM WITH PROBLEMS CAUSED BY GOK-TENDERING PROCEDURES.

9. ACTION REQUESTED: IN LIGHT OF ABOVE, EMBASSY REQUESTS FOLLOWING:

A. IN ADDITION TO INFORMATION REQUESTED REF B, TREASURY SHOULD SEND MODEL SURETY BOND CONTRACT, FOR USE BY FHWA MACDONALD IN HIS DISCUSSIONS WITH MPS CHIEF ENGINEER AND UNDERSECRETARY. EMBASSY, MCFADDEN AND MACDONALD AGREED THAT SUCH A MODEL WOULD BE USEFUL IN BRIEFING OFFICIALS WHO ARE UNFAMILIAR WITH BASIC MECHANISM INVOLVEDV;
B. ADDRESSES SHOULD COMMENT, MAKE SUGGESTIONS, ETC, ON PROPOSAL THAT EMBASSY INITIATE CONTACTS WITH GOK MINISTERS. SPECIFICALLY, SUBJECT TO APPROVAL BY ADDRESSEES, EMBASSY WILL

SEND DIPLOMATIC NOTE TO RELVEVANT GOK MINUSTRIES (INCLUDING MPW), OUTLINING U.S. PROBLEMS INVOLVING PERFORMANCE GUARANTEES AND PROPOSED SURETY BOND ALTERNATIVE. THIS WOULD BE FOLLOWED BY MEETINGS BETWEEN AMBASSADOR AND GOK MINISTERS.

C. ADDRESSEES SHOULD COMMENT ON POSSIBILITY THAT FORMAL SURETY BOND TEAM, CONSISTING OF BOTH USG OFFICIALS AND U.S. SURETY INDUSTRY REPS VISIT KUWAIT DURING FALL TO TAKE UP SUBJECT WITH SENIOR GOK OFFICIALS FOLLOWING CERTAIN PREPARATIONS HERE. THOUGH WE THINK SUBJECT MATTER WOULD BE SIMILAR TO THAT DISCUSSED IN FEBN ARY VISIT, TEAM PURPOSE WOULD BE TO CONTINUE DIALOGUE AT HIGHER LEVEL AS WELL AS TO FOCUS MORE COLSELY ON SUCH PROBLEMS AS NATURE OF GUARANTEE INSTRUMENT, MECHANISM OF ISSUANCE AND NATURE OF LOCAL REPRESENTATION.
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